Specification:

BACKGROUND OF THE INVENTION--FIELD OF INVENTION

Please replace the description with the following sentence.

This invention relates to providing coverage for loss expenses ~~when a separate contract of insurance or reinsurance is in-force~~ that are difficult or impossible to insure.

BACKGROUND OF THE INVENTION

For the section titled Loss Definition and Valuation, please replace all the paragraphs after the first paragraph with the following paragraphs.

To be eligible to receive insurance payments, insurance buyers must be able to prove that they had losses and that those losses fit within the coverage definition of their insurance. Losses can be categorized in many different ways such as life, health, property, casualty, etc. More generally, losses can be categorized as being direct or ~~collateral~~ indirect.

A direct loss is ~~essentially the loss itself~~ a loss where the insured peril is the proximate cause of the loss. ~~A collateral loss, sometimes referred to as an indirect or consequential loss, is engendered by the same event that produces the direct loss or by the direct loss itself.~~ For example, the direct loss of a factory due to a fire would be the cost of rebuilding the factory. The ~~collateral~~ indirect losses would be all of the costs associated with the inconvenience of not having a workable factory. Direct losses, such as the physical cost of the buildings in this example, are typically much easier to estimate than ~~collateral~~ indirect losses such as lost income or extra expenses that may result from such an event. Management and employees must spend time trying to recover from this event, and there is always a significant amount of opportunity cost that can never be adequately assessed.

Consider for example the loss of an automobile. Since it is a physical thing, it should be obvious that there was a loss and the extent of that loss. Nevertheless, the ~~collateral~~ indirect costs (for example lost time and other expenses) associated with fixing or replacing the car and the opportunity costs of not having a working car are not typically covered by

insurance. Similarly, insurance may cover the direct cost of paying for and defending against a liability claim, but it typically would not cover the costs necessary to restore an entity's reputation via an advertising program or to institute new practices and procedures.

~~While collateral~~ Indirect losses vary in size depending on the specifics of the loss, ~~it is clear that~~ but they occur with every type of insurable loss. Although insurance can cover certain limited types of indirect costs such as the loss of income (business interruption) and "extra" or "expediting" expenses that are necessary to return a business to normal after a loss, ~~In most cases,~~ companies and individuals are not typically insured against ~~collateral~~ indirect losses because these losses are often too difficult to define in advance or prove after the fact to make an insurance transaction economically viable ~~for both insurers and insurance buyers~~.

Furthermore, policyholders often have considerable discretion over ~~collateral~~ indirect losses, making them impossible to quantify and subject to significant moral hazard.   Since ~~collateral~~ indirect losses are becoming an ever larger part of most companies' loss experience, it is no wonder that companies are increasingly frustrated with insurance.

For the section titled Loss Definition and Valuation, please add the following three new paragraphs to the end of this section.

One consequence of having a large loss is that an entity's future insurance premiums may increase. Since this additional cost is not subject to the discretion of the insured, it is relatively easy to finance. To the extent that an insured is interested in purchasing this kind of coverage, an insurance company could just charge some extra amount of premium to smooth the eventual cost of the premium increase. This financing mechanism is similar to a heating oil company that charges its customers more than it would otherwise charge in the summer, when oil prices are lower, and less than it would otherwise charge in the winter. This smoothes the price variation of oil so its customers can more accurately budget for their heating cost.

For clarity, we are defining "collateral losses" to be a subset of indirect losses that have not been covered by insurance because they are subject to the discretion of the insured.

Collateral losses arise from insured events but are too difficult to define, prove, or measure to be covered by an insurance policy in the traditional way.

As a result, insurers and reinsurers can purchase various forms of reinsurance that cover the losses and loss expenses related to the insurance and reinsurance that they write, but they have no means of buying protection for the collateral losses that they experience from these same events. Collateral losses for insurers, reinsurers, and other intermediaries include such things as lost income, lost productivity, credit losses, additional borrowing costs, reputation maintenance expenses, accounting expenses, legal costs, consulting, and other types of discretionary expenses that are related to insurance and reinsurance losses.

For the section titled Agreed Value, please replace the last two paragraphs with the following three paragraphs.

Inventory or cargo insurance is another example of where this principle has been applied to direct losses. With inventory it is generally accepted that different types of companies have incurred costs that are greater than the purchase price of the goods they own. From an economic perspective, the value is not the invoice cost but the replacement cost of the inventory at a particular stage in the production, transportation, and retailing process.

Rather than dispute this point, insurers and insureds often agree to a stated percentage above the purchase price of the goods. Under this arrangement, the insurer and the insured increase the limit of the insurance to some commercially reasonable amount, and the price of this coverage is increased to take account of the higher loss valuation.

Thus, if the insured chooses to buy this extra coverage in an amount of 10% and has a loss, the insured will be paid the invoice amount for the goods that were lost plus an additional 10%. In this example, it is easy enough to define the potential losses in advance and to prove those losses after the fact, but the use of the agreed value principle helps eliminate the expense of having to measure the loss.

BACKGROUND OF INVENTION-OBJECTS AND ADVANTAGES

Please replace the second paragraph of this section with the following paragraph.

Secondary Loss Expense Coverage was originally conceived as a means of helping companies other than insurers and reinsurers obtain a new and more cost-effective way to finance the aforementioned types of expenses based on a set of relationships to an insurance policy. However, subsequent investigations have demonstrated that this concept also holds great promise as a means of helping insurers, reinsurers, and other parties that may be involved in the insurance or reinsurance business obtain coverage for costs that are collateral to the losses and loss expenses that they underwrite at attractive prices.

DRAWINGS—FIGURES

Please replace this section with the following paragraphs.

Fig 1 shows how an insurer might use a Collateral Coverage Contract in relation to its underlying insurance policies and outlines the various parties to these contracts a Collateral Coverage Contract that bears a functional relationship between its premiums and the premiums paid for the underlying insurance policy or policies as well as a functional relationship between the losses that are recovered under the two contracts.

Fig 2 shows the relationship between a Collateral Coverage Contract and an underlying reinsurance policy or policies and outlines the various parties to these contracts a Collateral Coverage Contract that uses functional relationships to an underlying reinsurance policy or group of such policies to determine the coverage it will provide and the amount of premium that will be charged for this contract.

Fig 3 is a chart and a table that demonstrates the cost and benefits of Collateral Coverage in relation to an underlying group of insurance or reinsurance policies relationship between a 30% Proportional Collateral Coverage Contract and a reinsurance policy and shows the costs and benefits of this coverage.

Fig 4 is a flowchart that demonstrates how simple and cost effective it is to perform underwriting and loss adjustment functions using Collateral Coverage, even for loss

~~expenses that are hard to define or prove~~ when the premiums and losses of the Collateral Coverage Contract bear functional relationships to the premiums of an insurance or reinsurance policy, or group of policies and the losses recovered under those policies.

DETAILED DESCRIPTION--FIGS 1 - 4--PREFERRED EMBODIMENT

Please replace the first four paragraphs of the section titled Product Overview with the following six paragraphs.

~~An overview of how an insurer might use a Collateral Coverage Contract in relationship to its underlying insurance policies is shown in Fig 1.~~ Fig 1 shows how an insurer might structure a Collateral Coverage Contract so as to purchase collateral loss coverage on a policy or group of policies that it has written. Fig 1 also shows the various parties to this contract and how the premiums and losses of this contract may be related to the premiums paid for and the losses recovered under an insurance policy or group of policies.

An insurer **1** writes an insurance policy or group of insurance policies **2** for an insured or group of insureds **3**. The insurance policies may have one or more coverage parts and may specify various deductibles, retentions, limits, coinsurance, and exclusions. The insurer uses a Collateral Coverage Contract **4** to purchase collateral loss expense coverage based on ~~the performance of~~ the losses it will pay on the insurance contract or group of contracts it has written **2**.

The Collateral Coverage Contract has two pre-specified functional relationships to the insurance policy: the contract's ~~losses~~ loss payment **5** ~~are a~~ is a mathematical function of the losses that are recovered under one or more coverage parts of the insurance policy or policies; and the contract's premiums **6** are a mathematical function of the premiums paid for one or more coverage parts of the insurance ~~policy's premium~~ policy or policies. Although these relationships may be expressed in many different ways, ~~it must~~ they must give the insurer value and allow a loss protection seller **7,** also referred to as the coverage seller, to make money.

The loss payment of the Collateral Coverage Contract may exclude certain types of losses that are recoverable under the insurance policy or group of policies it references and may specify additional deductibles, retentions, and limits. The loss protection seller **7** may be another insurer, a reinsurer, or some other entity that is interested in providing Collateral Coverage.

Fig 2 shows how a Collateral Coverage Contract may be used in conjunction with a reinsurance policy or ~~group of reinsurance~~ policies. A reinsurer **10** writes reinsurance policies **11** for reinsurance buyers **12** such as insurers and reinsurers. The loss protection seller **17**, also referred to as a coverage seller, may be another insurer, a reinsurer, or some other entity that is interested in providing Collateral Coverage.

The Collateral Coverage Contract **14** has two pre-specified functional relationships to the reinsurance policy or policies: the contract's ~~losses~~ loss payment **15** ~~are a~~ is a mathematical function of the losses that are recovered under ~~the insurance policy~~ one or more coverage parts of the reinsurance policy or policies; and the contract's premiums **16** are a mathematical function of the ~~insurance policy's~~ premiums paid for one or more coverage parts of the reinsurance policy or policies. Although this relationship may be expressed in many different ways, it must give the buyer value and allow a loss protection seller **17** to make money.

Please replace the first paragraph of the section titled Cost/Benefit Analysis with the following paragraph.

Fig 3 illustrates the cost and benefits of Collateral Coverage in relation to a reinsurance policy. In this example, an insurer is concerned about catastrophic losses that it may have. It is considering the purchase of a reinsurance policy to cover pre-specified losses that might occur in the range from $30 million to $100 million. The insurer recognizes that there are likely to be collateral losses that are uninsurable over this range of loss experience and would like to obtain coverage for them if possible. The insurer has three choices.

a. Buy no reinsurance and suffer losses as they occur.

b. Purchase a reinsurance policy for a premium of $5 million that contains a deductible of $10 million and a coverage limit of $50 million.

c. Buy the reinsurance policy and supplement it by purchasing Collateral Coverage equal to 30% of the reinsurance policy. This would cost 30% of the reinsurance policy's premiums, or an additional $1.5 million, and would pay 30% of any losses that are recovered under the reinsurance policy.

The graph in Fig 4 shows the net cost or benefit of each of these options over the relevant range of loss experience. The total cost or benefit equals the loss amount minus premiums and deductibles, plus any insurance and any Collateral Coverage ~~recoveries~~ loss payments.

Please replace the first paragraph of the section titled Method of Underwriting and Loss Adjusting with the following paragraph.

The flowchart ~~in Fig 3~~ in Fig 4 illustrates how an entity that desires to sell Collateral Coverage could use this business method to eliminate most of the work that is currently required to underwrite loss coverage and to adjust claims. First, a coverage seller creates two functional relationships **20**. One relationship defines the losses paid by Collateral Coverage in terms of the losses that will be recovered under one or more coverage parts of an insurance or reinsurance policy or group of such policies, and the second relationship defines the premium of the Collateral Coverage Contract in terms of the premiums paid for ~~these policies~~ one or more coverage parts of these policies. ~~Next, the coverage seller communicates its willingness to offer coverage on these terms to potential buyers 22. For example, the following schedule might be used to communicate that the coverage seller is willing to provide Collateral Coverage on a basis that is proportional to the underlying insurance or reinsurance.~~

Please insert the following six new paragraphs after the first paragraph of the section titled Method of Underwriting and Loss Adjusting.

Defining loss coverage involves three decisions. First, one must specify the loss payments on which the Collateral Coverage Contract will be based. This involves

specifying one or more coverage parts of the insurance or reinsurance policies and any types of losses paid within these coverage parts that will be excluded from the Collateral Coverage Contract.

Exclusions may be based on the cause of loss such as a hurricane, terrorism, earthquake, etc. Losses may be excluded because they did not occur in conjunction with some particular type or cause of loss. They may also be based on the relationship of loss payments from different coverage parts of an insurance policy. For example, one might specify that there will be no Collateral Coverage payment unless a payment is made under a particular coverage part of the insurance or reinsurance policy or policies to which it refers. Exclusions may be based on many other factors as well.

Second, one must define the relevant range of the Collateral Coverage by specifying any deductibles, retentions, and limits that will restrict the amount of this loss payment. Third, one must specify the mathematical function that will be used to determine how much the Collateral Coverage payment will be for a given amount of the specified loss that is paid over this relevant range.

This mathematical function may be structured so that the Collateral Coverage is proportional or nonproportional to the loss recoveries specified within the relevant range. This coverage is proportional if it specifies a percentage of Collateral Coverage for every dollar of loss recovery within the relevant range. For example, one might specify that the Collateral Coverage payment will be 10% of a particular property insurance policy's payments made under Coverage A, excluding losses from hurricanes, less a $5,000 deductible, and subject to a limit of $5 million.

Nonproportional Collateral Coverage may specify a binary relationship, i.e. if there are insured loss recoveries within the relevant range a particular sum of money will be paid. Alternatively, nonproportional Collateral Coverage may be scaled based on the size of the losses recovered within the relevant range. For example, one might specify loss coverage that pays nothing for the first $100 thousand of specified loss recoveries, pays 10% of specified loss recoveries between $100 thousand and $1 million, and then pays 20% of specified loss recoveries subject to a limit of $2 million loss coverage.

Having developed loss payment and premium relationships based on one or more coverage parts of an insurance or reinsurance policy or group of such policies, the coverage seller uses some means of communicating this information about its willingness to offer coverage on these terms to potential buyers **22**. This could be communicated via an intermediary, a telephone, radio, mail, the internet, or any other means of communication. For example, the following schedule might be used to communicate that the coverage seller is willing to provide Collateral Coverage on a basis that is proportional to the underlying insurance or reinsurance.

Please replace the paragraph Additional Embodiments with the following paragraph.

Although the basic methodology for Collateral Coverage remains the same as described above, there are numerous embodiments of this concept. This method can be applied to all types of insurance and reinsurance policies including property, casualty, health, and life insurance coverages life, disability, workers' compensation, etc. Collateral Coverage can be offered by insurers, reinsurers, banks, or other types of entities. Furthermore, Collateral Coverage can be offered in the form of an insurance policy or some other type of contract, act as an endorsement to an existing insurance or reinsurance policy, or take many other contract forms. Collateral Coverage may be offered in amounts that are directly proportional or indirectly related to the premiums paid and the losses that are recovered from the underlying insurance or reinsurance coverage.

Please add the following two new paragraphs to the section titled Additional Embodiments.

Collateral Coverage offers tremendous flexibility in defining mathematical functions that can be applied to insured loss payments. This function can be based on the losses paid on one or more coverage parts of an insurance or reinsurance policy or group of such policies and can limit such coverage further by specifying additional exclusions, deductibles, retentions, and limits. Having specified the loss recoveries and a relevant range over which the Collateral Coverage applies, one can then create mathematical

functions that bear all types of proportional and nonproportional relationships to the relevant range of specified insured loss payments.

Also, Collateral Coverage lends itself to many different business models. One might predefine acceptable combinations of loss payments and premiums and communicate this information to potential buyers so as to substantially reduce transaction expenses. However, this is not necessary to make Collateral Coverage valuable and worthwhile. Coverage sellers could just indicate their willingness to offer this type of coverage, and set their premiums on a case by case basis.